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MINISTRY OF FINANCE

(Department of Economic Affairs)

RESOLUTION

New Delhi, the 3rd December, 1953

REPORT OF THE INDUSTRIAL FINANCE CORPORATION ENQUIRY
COMMITTEE—ACTION ON THE—

No. F.2(70)-F.III/53.—During the course of discussions on the Industrial Finance Corporation (Amendment) Bill, 1952, certain criticism about the working of the Corporation was made in both the Houses of Parliament. The principal allegations were of nepotism and favouritism in the grant of loans particularly to big industries. The Government of India decided that these charges should be investigated by an impartial Committee. In December, 1952, a Committee was accordingly set up under the Chairmanship of Shrimati Sucheta Kripalani, M.P., to enquire into the working of the Corporation. The terms of reference of this Committee, whose other members were Shri V. B. Gandhi, Shri Sri Narayan Mehtha, Shri P. A. Narielwala, Shri R. Suryanarayana Rao and Shri G. Basu, were;

- (1) to scrutinise the loan transactions of the Corporation with reference to the allegations about nepotism and favouritism, made during the discussion of the Industrial Finance Corporation (Amendment) Bill in Parliament;
- (2) to verify whether in general due care has been exercised in the grant of loans;
- (3) to review generally the policy followed by the Corporation in the grant of loans with due regard to the objectives of the Act and the directions issued by the Government; and
- (4) to make recommendations, if necessary, for improvement in the working of the Corporation.

The Committee submitted its Report on the 7th May 1953.

2. In its report the Committee has made a number of general recommendations and dealt at length with a specific loan namely that granted to the Sodepur Glass Works. The case of the Sodepur Glass Works is still under Government's consideration and the final decision of the Government will be announced in due course. Meanwhile, this resolution sets out the decisions taken by Government on the general recommendations and conclusions of the Committee.

3. In regard to the first term of reference, the Committee has not found that the allegations made in Parliament about partiality and favouritism were established and has generally exonerated the Corporation. It has, however, made some unfavourable observations to the effect that applications in which the

Chairman or other Directors take interest receive more expeditions and liberal treatment and that the Corporation carries a bias in favour of established concerns with which any prominent industrialist is associated. The material on which these remarks are based is not given in the report although the Committee has made certain observations in its examination of individual cases, which might suggest that some favour or leniency was shown. Government have had every one of these cases most carefully examined and find it difficult to accept the view expressed by the Committee especially in regard to liberality of treatment meaning thereby larger loans or easier conditions not justified by business considerations. Government have no hesitation in agreeing with the Committee that the charges of nepotism and favouritism against the Corporation have not been proved.

3A. The recommendations of the Committee may, for convenience, be grouped into three classes, viz. administrative and organisational matters, procedural matters and matters of policy. In the following paragraphs a brief analysis of the recommendations and the action proposed to be taken on them are set out.

4. (A) ADMINISTRATIVE AND ORGANISATIONAL.

(i) *Para. 38.—The Corporation should be remodelled so as to have a full time paid Chairman to be assisted by a General Manager in place of the present arrangement of an Honorary Chairman and a paid whole-time Managing Director.*

Government agrees in principle that it would be an advantage to have a whole-time paid Chairman. This will require an amendment of the Act.

(ii) *Paras. 39 & 43.—Every branch office should have a regional panel of advisers out of which a few could be selected ad hoc to deal with each loan application and the Board of the Corporation should occasionally meet in Bombay, Calcutta, Madras, etc.*

Government agrees that the Board of the Corporation should occasionally meet at important centres other than Delhi which is its Headquarters as suggested by the Committee. The suggestion about panels of regional advisers for the branch offices has been carefully considered, but having regard to the fact that the Corporation is a financial institution dealing in a special type of loan finance, Government considers it preferable that the Corporation should obtain advice on a functional rather than a regional basis. To secure proper consultation with industry the Corporation have already appointed a Textile Advisory Committee and are considering the appointment of similar other functional committees for different groups of industries.

(iii) *Para. 48.—Too much concentration of powers in the hands of the Managing Director is undesirable, and the duties and powers of the Managing Director and the Deputy Managing Director should be well defined.*

In deference to the observations of the Enquiry Committee, the Corporation have already under examination how far the existing procedure needs to be changed consistently with the ultimate responsibility of the Chief Executive. Moreover, when a full-time Chairman is appointed he would be the Chief Executive and the problem would no longer survive.

(iv) *Para. 48.—The right to appoint Directors on the Board of loanee companies should be more generally observed, such representatives should function as Directors of the loanee companies and not act merely as observers and they should be authorised to sign the balance sheet and profit and loss account of the borrowing concerns.*

The Corporation does exercise the right to nominate Directors on the Boards of the borrowing concerns as and when they feel it necessary to do so and the representatives of the Corporation function as Directors and not merely as observers. As regards the representatives of the Corporation signing the balance sheets, etc. Government sees considerable force in the Corporation's view that by doing so, there is risk of the representatives getting unnecessarily involved in possible litigations and would leave the matter to the discretion of the Corporation.

(v) *Para. 26(2).—It should be ensured that the Board of the Corporation is not dominated by big industrial interests and that in nominating members of the Board, the Government should see that an economist, a managerial expert and a chartered accountant are included. One of the nominated Directors should also be a person interested in the development of small industries.*

Government are generally in agreement with these views. Since Government must necessarily have some representatives on the Board, it may not always be

feasible to include in the nominations all the interests mentioned by the Committee and it may sometimes happen that one of the other Directors is an economist or a managerial expert etc.

5. (B) PROCEDURAL.

(i) *Paras. 20, 22 and 53.*—A Director of the Corporation who has any interest in an industrial concern which has applied for a loan should disclose his interest in the loan. A concern in which a Director of the Industrial Finance Corporation is a Managing Director or a Director/Partner/Shareholder in the Managing Agency concern should not be eligible for loan. Any loan to a concern in which a Director of the Corporation is only an ordinary Director or a Shareholder should require the unanimous vote at a meeting of the Board of Directors in which at least 2/3rds of the Directors qualified to vote should be present. A Director of the Corporation who is interested in any loan transaction should not be present at the meeting of the Executive Committee of the Board where the particular loan is under discussion.

Government agree that Directors of the Corporation must invariably disclose whatever interest they may have in applications pending with the Corporation. This suggestion has already been accepted by the Corporation. Government also agree that the Director concerned should withdraw from the meeting when the application in which he is interested is under discussion.

At present, nearly 60 per cent of the share capital of the Corporation is contributed by banks, insurance companies, cooperative banks, etc., who have a right to return 6 out of the 12 directors on the Board excluding the Managing and Deputy Managing Directors. These Directors, at any rate, are likely to be Managing Directors or partners or shareholders in the managing agency concern of some of the applicant companies. The total exclusion of all such companies from eligibility for loan from the Corporation would not only be a hardship to the companies but may not even be practicable unless the entire character of the Corporation is changed and the capital composition radically altered. The Banking Companies Act imposes restriction on unsecured loans only whereas all loans by the Corporation are granted on proper security. The Corporation have, however, agreed that loan applications in such cases may be reserved for the full Board. The presence on the Board of two Government officers, who can be given requisite directives in the matter, also affords a further safeguard in such cases. Government have further decided to direct the Corporation to report to Government all cases of the grant of loans in which a Director of the Corporation is a Managing Director or a Director/Partner/Shareholder in the managing concern of the applicant undertaking. As regards cases of loans to companies in which a Director of the Corporation is an ordinary Director or shareholder, attendance of 2/3rds of the Directors at the Board meeting and unanimous decisions would be inconvenient in practice but Government have decided that all such cases should be reported to Government if loans are sanctioned at meetings at which less than half the Directors are present or the decision is not unanimous.

(ii) *Paras. 32, 36 and 37.*—The Board of Directors should usually exercise the final authority regarding the sanctioning of loans and a convention should be established requiring the Executive Committee to keep back difficult and important cases for the Board's approval. In the alternative, the present Executive Committee may be abolished and a Loan Committee constituted to assist the Board. The detailed terms and conditions of loans should not be left to be negotiated by the Managing Director.

The recommendation that the Board should usually exercise the final authority for sanctioning loans seems redundant since under Section 6 of the Act general superintendence and direction of the affairs and business of the Corporation is entrusted to the Board of Directors and the final responsibility in respect of loans as in other matters is that of the Board. Government agree that the Executive Committee should reserve for the Board cases that it considers difficult. It is open to the Board from time to time to give directions that particular categories or kinds of applications should be reserved by the Executive Committee for the Board's consideration. Government feel that it would not be proper to restrict the authority of the Board to function through sub-committee. Whether it is necessary to change the nomenclature of the Executive Committee to Loan Committee will be considered in due course.

Government understand that in fact it is the present practice of the Board and the Executive Committee to sanction the essential terms and conditions of loans (which have been largely standardised) in each case; the Managing Director is charged only with securing acceptance of the terms and conditions and

any variations therein other than those of minor detail have to be referred again to the Executive Committee or the Board as the case may be. Government are satisfied that no change is called for in this procedure.

(iii) *Paras. 26(3), 46 and 47.*—*The Corporation should publish more informative and comprehensive annual reports and quinquennial reviews disclosing names of all loanes, setting out of activities and fortunes of individual borrowing concerns and surveying the trend of development in the industries generally, etc. The form of balance sheet and profit and loss account statements should also be revised.*

Government agree that the annual reports of the Corporation should be as informative as possible. Government have also decided to direct the Corporation to publish the names of borrowing concerns to whom loans are sanctioned. Government consider that any attempt to assess the fortunes of individual borrowing concerns is likely to be objectionable from the point of view of its possible effect on the credit of the concerns but agree that general reviews of development of industries particularly in the field in which the Corporation has advanced loans should be attempted by the Corporation in its reports. Government also agree that the reports of the Corporation should contain fuller particulars in all other respects as recommended by the Committee.

As regards the form of balance sheet, Government have referred the matter for advice to the Comptroller & Auditor General who is vested under the recent amendment to the Act with powers to audit the accounts of the Corporation.

(iv) *Paras. 27, 28, 29 & 30.*—*A minimum margin of 50 per cent. should be observed in sanctioning loans; care should be taken to ensure that the value of their assets is not inflated by the borrowing concerns; greater attention should be given to the proper assessment of the earning capacity of the borrowing concerns; the financial stakes of the Directors and the Managing Agents of the applicant concern should be taken into account; and the long term capital needs of the concern should be fully appraised before a loan is granted. The Managing Agents of any borrowing concern should not be at liberty to dispose of their share-holdings in the borrowing concern without the prior approval of the Corporation.*

Their commendations are generally acceptable to the Government and it is understood that, in fact, they are in conformity with the standards and practices that the Corporation has been following.

Government agree that the financial stake of the Managing Agents or Managing Directors should be taken into account but consider that it would not be desirable to insist on any particular minimum share-holding by them in the borrowing concern. The Corporation have pointed out that the personal guarantee of the managing agents is also taken as a rule as additional security.

As for non-disposal of shareholding in a borrowing concern, Government consider that where such financial stake has been taken into account by the Corporation as a factor of safety, transfer without the approval of the Corporation should be prohibited.

(v) *Paras. 34 and 35.*—*Delays in sanctioning loans in disbursing money against loans should be reduced, particularly delays involved in examination of legal titles and documents. Legal expenses recoverable from the borrowing concerns should be brought down and the Corporation should fix a graduated scale of fees to cover legal costs. The practice of part payments of loans on the hypothecation of assets pending completion of mortgage deeds should also be adopted.*

Government agree with the Committee that every attempt must be made to minimise delays and to reduce costs to the applicant borrower. The Corporation has already evolved suitable standard drafts and the cost to the applicants for such drafting is thereby reduced. The Corporation is already making interim loans wherever possible pending the execution of regular mortgage deeds.

(vi) *Para. 25(5).*—*The Industrial Finance Corporation should have a proper agency of technical staff, etc.*

Government accept this recommendation. In fact, a Technical Advisor has been recently appointed by the Corporation. Besides, on technical questions, the Corporation freely draws on the technical advice of the Commerce and Industry Ministry or the concerned Ministry of Government.

(vii) Para. 40. When a concern has to be taken over by the Industrial Finance Corporation it should be entrusted, as a general rule, to a nominated Board of Directors in preference to departmental management or management through a managing agency firm. Sale of such an Industrial concern should not be made except under very special circumstances and without prior reference to the Government.

The only concern which the Corporation so far has had occasion to take over, viz., Sodepur Glass Works is being run by a nominated Board of Directors. The experience of the Corporation, however, in this regard until now is extremely limited and Government do not consider it desirable to lay down any hard and fast rule.

As regards the sale of such a concern, Government consider that it would not be desirable to pre-judge a matter in a general way as suggested and that the Corporation must be left to judge each case on its own merits. Government also consider it important that the responsibility of safeguarding its own interest and recovering its own monies of a Statutory Corporation like this should not in any way be qualified. The Government Directors may be left to represent to the Board any point of view of public policy that might be relevant in Government's opinion in connection with any concrete case.

C. MATTERS OF POLICY

6. (i) Paras. 25(4), 25(8) and 25(5). The Corporation should conform to the priorities for industrial development as laid down in the Plan and to the programmes of development in respect of 42 industries recommended by the Planning Commission. No loan should be granted by the Corporation generally in respect of industries where "the saturation point" has been reached.

Government agree with the recommendation that the priorities drawn up by the Planning Commission should be given due weight by the Corporation. The programmes of development in respect of 42 industries drawn up by the Planning Commission do not, however, exhaust the entire development in the private sector envisaged in the Plan. Since the enactment of the Industries (Development and Regulation) Act, licences are now required for the setting up of new units or 'substantial expansion' of existing units and Government understand that the Corporation have already adopted the practice of not considering applicant concerns within the licensable field for grant of loans until they have obtained licences from the Commerce and Industry Ministry.

As regards the so-called saturated industries Government agree that loans should be restricted only to proposals for rehabilitation or modernisation. They consider, however, that it may not be possible to have any rigid criteria putting a complete ban on loans to such industries as suggested by the Committee.

(ii) Paras. 25(7), 26(9), 45(7) and 54, with reference to Section 6(3) of the Industrial Finance Corporation Act, Government should issue directives to the Corporation regarding principles that should be followed by the Corporation. Government should give to the Corporation a clear indication as to which regions or areas should be treated as backward, with a view to enabling the Corporation to give a preference to such areas. The Corporation should be directed to refer all loans in excess of Rs. 50 lakhs for sanction to the Central Government at ministerial level for the next 3 years. Government should consider whether directives should not be issued to the Corporation outlining the policy that should be followed in the matter of grant of loans for non-productive purposes (e.g. construction of labour quarters, canteens, roads in the factory area, etc.)

The Industrial Finance Corporation represents a new experiment in the field of industrial finance and principles could be evolved and practices established only in the light of actual experience. Moreover, two senior officers of Government have been serving as Directors on the Board of the Corporation and even otherwise, there has been close liaison between the Corporation and the Ministries and other governmental agencies. For these reasons, there has not so far been any occasion to issue a directive to the Corporation except once sometime in 1948. In the light of the experience now available and the recommendations of the Enquiry Committee, Government would issue directives to the Corporation embodying its decisions recorded in this resolution.

The Committee have themselves acknowledged the difficulty of particularising the backward areas. Hitherto the funds of the Corporation have been sufficient to deal with all eligible applications so that there has been no occasion for according regional priorities. Government will, however, consider the question of issuing a directive in respect of any particular backward region if and when the necessity arises.

The competence of the Corporation to grant loans in individual cases beyond Rs. 50 lakhs was enhanced by law as recently as in 1952. Since then, there has been no case of any individual loan exceeding Rs. 50 lakhs. Government do not see sufficient justification for altering the present position and qualifying this power by requiring loans exceeding Rs. 50 lakhs to be put up for Government sanction. Government however, agree that all loans in excess of Rs. 50 lakhs should be reported to Government.

As regards the grant of loans for non-productive purposes, while Government agrees that the more essential items of expenditure should receive priority of consideration at the hands of the Corporation, there would be obvious difficulties in practice in making a distinction between productive and non-productive expenditure. Government understand that the Corporation is already alive to the considerations in the mind of the Enquiry Committee. Thus, for instance, since the introduction of the Industrial Housing Scheme by Government, the Corporation has been disallowing the utilisation of loan advances for purposes for which the companies would be eligible for assistance under the scheme. Government are satisfied that it is best to leave the matter as it is.

(iii) *Para. 41.—No strong case for the nationalisation of the Corporation at this stage has been made out. Direct interference by Members of Parliament in the day to day administration of the Industrial Finance Corporation should, be avoided, but with a view to enable Parliament to look more systematically into the affairs of the Corporation and other similar statutory corporation, the appointment of a Public Corporation Committee of Parliament may be considered.*

The views of the Committee have been noted by Government that there is at present no case for nationalisation of the Industrial Finance Corporation.

As regards the recommendation that a Public Corporation Committee of Parliament should be constituted for looking into the affairs of this and other statutory corporations, Government are of the view, for reasons already stated in Parliament on behalf of Government that such Committee is not necessary at the present stage of development.

(iv) *Para. 26(4).—The Corporation should not participate in equity or risk capital.*

This conforms to the practice hitherto followed by the Corporation and Government accept the recommendation.

(v) *Para. 26(4).—When the Reserve Fund of the Corporation aggregates to Rs. 5 crores, the question of participation in equity capital of concerns which have been paying dividends regularly may be considered. Government should also consider whether the Corporation should not be empowered to keep the right of converting a part or whole of the loan capital into share capital in such an event.*

The right to be vested in the Corporation would presumably be to acquire equity capital at par and by fresh issue when it desires to convert its loan into equity capital. The Corporation would obviously seek to do this when shares of the borrowing concerns are quoting at a premium and this would obviously be unfair to the shareholders of the concern. Government does not consider it advisable to vest such authority in the Corporation which would have the result of deterring would-be borrowers.

(vi) *Para. 26(7).—Private limited companies should not be eligible for grant of loans by the Corporation and the present statutory ban should continue.*

Government accepts the recommendation.

(vii) *Para. 42.—The Corporation may guarantee temporary loans which a borrowing concern may require from a bank from time to time.*

It is felt that since the Corporation is entitled to advance working capital in cases of difficulty, this is not necessary.

(viii) *Para. 44.—A system of deferred payments of interest should be allowed where interest charges prove to be a burden to a new project.*

This object is already being achieved by a more elastic arrangement, the Corporation allowing postponement of payment of interest in cases of genuine difficulty.

(ix) *Para. 49.—The definition of 'processing of goods' referred to under Section 2(c) of the I.F.C. Act should be widened.*

This is a matter of legal interpretation and as no difficulty has so far been reported, there is hardly any necessity for making a change.

(x) *Para. 50.—The question whether foreign concerns which though registered in India do not have a majority of shareholders of Indian Nationality should be eligible for loans should be considered.*

The position of foreign concerns of this kind must continue to be regulated by Government's general policy in respect of foreign companies and it is unnecessary to consider it separately for the purpose of loans by the Corporation.

(xi) *Paras. 51 and 52.—Where the individual States do not have the resources to have separate financial Corporations, joint Corporations for more than one State should be set up. The fields of the activities of the I.F.C. and the State Finance Corporations should be properly demarcated.*

Government agrees that it may be necessary to consider the setting up of a Joint State Finance Corporation by more than one State and has already addressed the State Governments indicating that they would be prepared to consider promoting the necessary amendments to the State Finance Corporations Act, 1951, to enable this to be done if any concrete demands are forthcoming.

The fields of activities of the I.F.C. and the State Finance Corporations are largely demarcated by the provisions in the relevant laws. State Finance Corporations have just started functioning and should occasion arise in the light of experience for more definitely demarcating the fields of the Central and State Finance Corporations, this would be considered.

(xii) *Para. 55.—Applicants for loans should produce proper income-tax clearance certificate and all parties before the Income-tax Tribunal should be excluded.*

Government agrees that companies which are known to be evading due taxes should not be eligible for finance through the Corporation. It is understood that full particulars regarding payment of income-tax are regularly obtained by the Corporation at the time of acceptance of applications and it seems unnecessary to prescribe production of income-tax clearance certificates which in some cases may not be available on account of the assessment being in arrears without any fault of the company.

7. The Government of India considers that the Report of the Committee is of great value in clearing some of the misconceptions about the working of the Industrial Finance Corporation. The Recommendations of the Committee should go a long way towards further improving the working of this institution which is a new experiment in the field of industrial finance in this country, so that it may play even more useful and vital part in the development of industry. The Government wish to record their thanks to the Chairman and Members of the Committee for the pains they have taken in conducting the enquiry and the valuable assistance they have rendered.

K. G. AMBEGAOKAR, Secy.

